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ABSTRACT

An overview investigation of two U.S. Department of Education college construction loan programs was conducted by a House of Representatives' subcommittee. Both programs, the College Housing Loan Program (CHLP) and the Academic Facilities Loan Program (AFLP), were created by Congress in response to upsurges in college enrollments. CHLP provides loans for such purposes as building new housing and the conversion or renovation of existing structures, while the AFLP allows for the construction, reconstruction, and renovation of academic facilities. Loans under the programs have been at low interest rates (about 3 percent) and long terms (up to 40 years). Study objectives were to determine: the efficiency of the Department's management of the programs, violations of law and regulations by borrowers participating in the programs; the adequacy of the Department's procedures for handling colleges in default on their federal loans, and the advisability of a departmental regulation to allow discounted prepayment of program loans during fiscal year 1984. The 3-month inquiry included examination of program documents and loan files at central program offices, interviews with program staff, and review of audits of delinquent borrowers. A hearing on the programs was also held. Findings and recommendations are included. (SW)

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Union Calendar No. 648

98th Congress 2d Session - - - - - - - - - - - - House Report 98-1164

INVESTIGATION OF THE DEPARTMENT OF EDUCATION'S COLLEGE CONSTRUCTION LOAN PROGRAMS

SIXTY-FOURTH REPORT

BY THE

COMMITTEE ON GOVERNMENT OPERATIONS

together with

ADDITIONAL VIEWS

U.S. DEPARTMENT OF EDUCATION
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LETTER OF TRANSMITTAL

HOUSE OF REPRESENTATIVES,
Washington, DC, October 16, 1984.

Hon. THOMAS P. O'NEILL, Jr.,
Speaker of the House of Representatives,
Washington, DC.

DEAR MR. SPEAKER: By direction of the Committee on Government Operations, I submit herewith the committee's sixty-fourth report to the 98th Congress. The committee's report is based on a study made by its Intergovernmental Relations and Human Resources Subcommittee.

JACK BROOKS, *Chairman.*

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98TH CONGRESS *2d Session* | HOUSE OF REPRESENTATIVES | REPORT 98-1164

INVESTIGATION OF THE DEPARTMENT OF EDUCATION'S COLLEGE CONSTRUCTION LOAN PROGRAMS

OCTOBER 16, 1984.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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Mr. BROOKS, from the Committee on Government Operations, submitted the following

SIXTY-FOURTH REPORT

together with

ADDITIONAL VIEWS

BASED ON A STUDY BY THE INTERGOVERNMENTAL RELATIONS AND HUMAN RESOURCES SUBCOMMITTEE

On September 25, 1984, the Committee on Government Operations approved and adopted a report entitled "Investigation of the Department of Education's College Construction Loan Programs." The chairman was directed to transmit a copy to the Speaker of the House.

I. INTRODUCTION

Under the House of Representatives Rule X, 2(b)(2), the Committee on Government Operations is authorized to "review and study, on a continuing basis, the operation of Government activities at all levels with a view to determining their economy and efficiency." The committee has assigned this responsibility, as it pertains to the Department of Education (DOEd), to the Subcommittee on Intergovernmental Relations and Human Resources.

Pursuant to its authority, the subcommittee conducted an oversight investigation of two DOEd college construction loan programs: the College Housing Loan Program (CHLP) and the Academic Facilities Loan Program (AFLP). Both programs were created by Congress in response to upsurges in college enrollments.

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The CHLP was authorized by Title IV of the Housing Act of 1950 (Public Law 81-475) "to assist educational institutions in providing housing for their students and facilities. . . ." The program was managed by the Housing and Home Finance Agency, the forerunner of the Department of Housing and Urban Development (HUD), until 1965, when it was transferred to HUD. In 1980, the CHLP was transferred from HUD to DOEd. Since its inception, the CHLP has provided $4.5 billion in loans to private and public colleges.

The AFLP was authorized by Title VII of the Higher Education Act of 1965 (Public Law 89-329), which established a program for the construction, reconstruction and renovation of academic facilities. The program was managed by the Department of Health, Education, and Welfare (HEW) until 1980, when it was transferred to DOEd. The AFLP has provided approximately $567 million in loans.

The subcommittee's investigation was conducted to determine the efficiency of DOEd's management of the programs; violations of law and regulations by borrowers participating in the programs; the adequacy of DOEd procedures for handling colleges in default on their Federal loans and the advisability of a Departmental regulation to allow discounted prepayment of program loans during fiscal year 1984.

The subcommittee's three-month inquiry included an extensive examination of program documents and loan files located in DOEd's central program offices. Interviews were conducted of program staff. In addition, subcommittee staff reviewed audits of delinquent borrowers conducted by the DOEd Inspector General and findings pertaining to the programs by the General Accounting Office (GAO).

On May 15, 1984, the subcommittee's investigation culminated in a hearing, which included testimony from DOEd Assistant Inspector General for Audit and the Assistant Secretary for Postsecondary Education, who was accompanied by program staff. The testimony addressed the current need for the programs; violations of loan agreements committed by individual borrowers; DOEd's procedures for handling institutions in default; and the pending discount regulation.

II. Background

The two loan programs examined during the subcommittee's May 15, 1984, hearing are similar in operation and purpose. Both the CHLP and the AFLP were established to meet housing and facility shortages created by booming college enrollments. Loans made under each program have been at low interest rates (approximately 3 percent) and long terms (up to 40 years). The loans can cover as much as 100 percent of construction costs.

A. College Housing Loan Program [CHLP]

The initial legislation passed in 1950 to establish the CHLP required that loans only be made to institutions that could not find comparable loan terms and conditions from other financial sources. The law set loan repayment terms at up to 40 years and set the interest rate for the loans at a percentage equal to the rate paid on

Federal Government obligations with maturities of a minimum ten years plus one quarter of one percent.

Eligibility for CHLP loans is limited to private and public educational institutions of higher education. Under the law, the loans can be used for such purposes as building new housing structures and the conversion or renovation of existing structures which are not adequate for housing.

The 1950 Act created a revolving loan fund to finance the program, and authorized the Housing and Home Finance Agency, which first administered the program, to borrow $300 million as capital for the fund. Appropriations were authorized to subsidize the difference between the payments of borrowers and payments due from the program on funds borrowed from the Treasury as capital for the revolving fund.

Since 1950, the CHLP has been altered by Congressional amendments at least 16 times, the majority of the amendments having been passed prior to 1970. Measures changing the program's authorization ceiling and the amount of interest charged to borrowers were the most common type of amendments. In 1955, Congress broadened eligibility requirements for the program to include additional types of facilities, such as student centers, health centers and dining halls.

Between 1950 and 1966, Congress raised the borrowing ceiling for CHLP seven times and lowered it once. By 1969, the cumulative borrowing authority reached $3.775 billion (only $2.8 billion was ultimately borrowed from Treasury). Since 1968, no additional increases in borrowing authority have been authorized.

In 1966, the Participation Sales Act of 1966 (Public Law 89-429) authorized the CHLP to sell certificates of participation. Two years later, Congress further expanded financing for the program to include debt service grants to facilitate additional borrowing from the private sector. Congress repealed the debt service grant authority in 1974.

President Nixon suspended new program loan authority in 1973 but, in 1975, Congress instructed HUD to begin making new loans from the revolving fund. HUD did not begin making new loans again until 1977, and new loans have been made annually from the fund since that time.

Annual loan collections financed through the sale of participation certificates were insufficient to redeem and pay interest on the certificates, and Congress authorized permanent and indefinite appropriations to cover the annual shortfalls. By fiscal year 1984, virtually all participation certificates were amortized, and there were no further appropriations needed to cover insufficiencies.

During fiscal years 1983 and 1984, Congress authorized $40 million in borrowing authority from the CHLP revolving fund.

B. ACADEMIC FACILITIES LOAN PROGRAM [AFLP]

The AFLP originated in the Higher Education Facilities Act of 1963. The Act provided funding for various types of academic facilities on college campuses. The authority was amended and transferred into Title VII of the Higher Education Act of 1965.

Under the Participation Sales Act of 1966, a revolving fund for the AFLP was established in the Treasury Department to receive appropriations for construction loans, interest payments, principal repayments or other funds and assets received by the Commissioner of Education under the construction loan title. All loans and obligations were to be paid through the Treasury fund.

The Education Amendments of 1976 (Public Law 94-482) expanded the AFLP to include reconstruction and renovation of existing college facilities.

C. OPERATION OF PROGRAMS

The programs are the responsibility of the DOEd Office of Postsecondary Education (OPE). The OPE Division of Facilities and General Support Programs has direct administrative authority over the programs. Within the division, the College Facilities Branch handles the approval and award of loans, and the Loan Management Branch handles the long-term management of loans outstanding.

Applicants for CHLP and AFLP loans submit initial enrollment and financial information to the College Facilities Branch. The applications are ranked on a scale of 100. The schools are judged on their enrollment figures at the time of the application. Past or future housing trends are not considered. Applicants must demonstrate a housing shortage in order to qualify for program loans. The only other major restrictions in the application and award process are that no more than 12 percent of each annual program appropriation be spent on any one State, and that 10 percent of available funds each year be awarded to historically black colleges.

Successful applicants are notified by DOEd that a reservation of loan funds has been made in their name. The applicants are then given 18 months to submit the second part of their applications, which consists of three parts: 1) a review of project data, 2) a financial review; and 3) a legal review.

When a school successfully completes the two-part application process, the loan is awarded. As part of the loan transaction, the school issues revenue bonds, which are purchased by DOEd. As the bonds mature on prescribed dates, DOEd is repaid. A trust indenture on payment of the bonds functions as a loan agreement, with all repayment terms and security stipulations contained in the indenture documents. As part of the loan agreement, borrowers can be required to pledge all revenues from buildings constructed with Federal loan proceeds, or other school revenues, for repayment of DOEd loans. For example, if a borrower uses its loan to construct a dormitory, all net revenues from student housing fees are pledged to repay the loan, or must be deposited in a reserve account. The borrower is also required to use the pledged facility as security for the loan. Additional collateral may also be requested, depending on the amount of the loan and the borrower's financial condition. Public schools usually pledge only project revenues because DOEd accepts the good faith and credit of the State.

Private borrowers select a banking institution to act as trustee, and trust indentures are secured which provide the loan terms and repayment periods for the bonds. Public schools participating in

the CHLP sign bond resolutions, and the treasurer of the school acts as trustee.

The loan is considered closed when the project is 80 percent complete. All funds are then disbursed to the borrower. After closing, the loan file is transferred from the College Facilities Branch to the Loan Management Branch, which functions as the collection arm of the CHLP and AFLP. The Federal Reserve Bank (FRB) in Richmond, Virginia, handles the actual collection transactions. The trustee forwards loan payments to the FRB. DOEd is not informed of how much is collected each month, only amounts which are past due. Delinquencies are reported monthly to DOEd by the FRB.

D. FUNDING

Since its inception, the CHLP has provided $4.5 billion in loans to private and public colleges for the construction of dormitories and other facilities. Nearly $3 billion of the loans are outstanding to 1,250 borrowers.

The AFLP has obligated approximately $567 million in loans for the contruction of classrooms, libraries and other facilities. About $410 million in AFLP loans are outstanding to 450 borrowers.

Delinquent payments for both programs, although small, are steadily increasing. The CHLP delinquency increased from $10.9 million in 1977 to $24 million as of May 15, 1984. The AFLP delinquency rose from $2.5 million in 1975 to $10.6 million as of May 15, 1984. The amount of total loans in default for the programs is $163 million, or 5 percent of the entire loan portfolio.

In FY 1983, DOEd had total collections from the program of $211.1 million, with $6.8 million coming from defaulted institutions. The FY 1984 collections, as of December 31, 1983, are $101.7 million.

Since 1969, AFLP loans have been made only through special appropriations for specific schools. The AFLP loan fund, at the time of the subcommittee's investigation, had $8 million available for new loans.

The CHLP continues to make new loans from its revolving fund, but the amount of funding that can be used for new loans is established through annual limitations set in the Education Appropriations bill. At the end of FY 1983, the CHLP revolving fund had a balance of $15.5 million; however, the fund balance changes on a daily basis. The CHLP has an outstanding loan balance of $2.675 billion on Treasury borrowings and a $451.4 million obligation for Government National Mortgage Association (GNMA) participation certificates which mature in 1987 and 1988.

III. Findings and Conclusions

A. SOME COLLEGES IN DEFAULT ON FEDERAL LOANS ARE UNDERREPORTING REVENUES PLEDGED FOR REPAYMENT OF THEIR CHLP DEBT

Under the CHLP, revenues generated by buildings financed with loan proceeds are pledged for debt repayment and used as security

for college housing loans.[1] However, the subcommittee's investigation found that colleges in default on their CHLP loans are avoiding required payments by improperly under-reporting revenues that are pledged for debt repayment.

The loan agreement, trust indenture (required of private institutions), bond resolution (required of public institutions) or mortgage note, prescribe the reporting requirements of the borrower, and stipulate that revenue accounts must be separately maintained by the borrower in order to prevent the diversion or commingling of funds pledged for debt repayment.[2]

Despite the requirement that project revenues be pledged to repay CHLP loans, some institutions participating in the program have under-reported revenues to DOEd by attributing unallowable costs to the project, thus reducing the true revenues of the building.[3]

An example of a school that under-reported project revenues is Ottawa University of Ottawa, Kansas. The school received four CHLP loans totalling $2.422 million in 1960, 1962, 1964 and 1967, years the program was managed by HUD. At the time of the subcommittee's hearing, the school was in default on the loans, with past due principal and interest amounting to $386,292.[4]

The subcommittee's investigation found that Ottawa University had attributed more than $500,000 in improper costs to pledged projects, had not segregated cost accounts for each pledged facility and had diverted pledged revenues to general operational costs.[5] An internal school memorandum explained some of these actions:

> In order to avoid showing artificial profit on the operations * * * we have for some years allocated financial aid expense and administrative costs to those operations * * * If we do not recognize these allocations we show a profit of approximately $100,000 on operations of auxiliaries, and HUD will certainly expect us to make substantial debt-

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[1] Under 34 CFR, Part 614.37(a), "A borrower shall evidence its loan by either notes or bonds issued by the borrower, secured by a mortgage, a trust indenture, or project revenue, or any combination thereof." Furthermore, according to the CHLP "Loan Management Manual," security for loans consists of "a pledge of project revenues (gross or net), a pledge of revenues from other sources, a pledge of funds or securities, and a first mortgage on the project and other pledged facilities where legally available."

[2] The College Housing Loan Program Loan Management Manual (1983) describes three types of segregated accounts: (1) "The Revenue Fund Account is the depository for all funds derived from the operation of the project, other revenues or sources which are pledged, and is the principal source of funding the other prescribed accounts. The Revenue Fund Account is generally established by the borrower as a separate account at an FDIC insured bank, and prevents the commingling of project and other pledged funds with the general operating funds of the institution, which is prohibited." (2) "The Bond and Interest Sinking Fund Account is the depository into which deposits are made for the purpose of paying interest and principal on the ED loan and provide a reserve therefor. Semi-annual payments in specified amounts are required until the Debt Service Reserve is fully established and thereafter sums sufficient for debt service. Such deposits are required to be made from pledged sources, and, in the case of general obligations, from the borrower's general funds, if necessary." (3) "The Repair and Replacement Reserve Account provides assurance of adequate maintenance of the facility. The amount of deposits required, aggregate level of deposits, and use thereof is stipulated under the Indenture of Bond Resolution."

[3] These schemes are detailed in the audits of CHLP borrowers conducted by the DOEd Inspector General.

[4] CHLP loan file on Ottawa University.

[5] Memorandum of Gene Kelly, CHLP Loan Servicer, "Ottawa University," March 29, 1982. This memorandum details the unallowable costs charged to pledged CHLP projects.

service payments. Nick Auer of Arthur Anderson & Company is reluctant to use the figures I provided.[6]

The memorandum is a clear admission that the school had knowingly under-reported project revenues to avoid payment of CHLP loans.

Another school that under-reported revenues to DOEd is Alaska Pacific University of Anchorage, Alaska. In 1962, the school received a $2.9 million CHLP loan. Alaska Pacific has received deferments on payments of the loan, and at the time of the subcommittee's hearing, was delinquent on $1.1 million in principal and interest. The school also received a $95,000 AFLP loan in 1966, which is in current status.

An audit conducted by the DOEd IG included the following findings:

> Revenues of $136,000, which had been pledged to repay the Federal loan, were not deposited in the project's revenue accounts, in violation of the loan agreement, which requires that project revenues be applied to repayment of the debt.
>
> Alaska Pacific's bookstore revenues, as reported to DOEd, were understated. The store was operated within a pledged facility and, thus, the revenues must be used to repay the CHLP loan.
>
> The school attributed $110,000 in improper costs to pledged facilities.
>
> Alaska Pacific, through substantial land holdings, had sufficient resources to repay its CHLP loan, yet remained past due on its loan payments.
>
> The college's accounting system did not segregate revenues and expenses for each of the pledged facilities.[7]

The audit findings concerning Alaska Pacific were referred to the IG Office of Investigation, but the investigation was closed when it was discovered that the school planned to "exercise its option," under a new authority given the Secretary of Education by Congress to discount loans, and that the loan would be repaid on a discounted basis.[8]

The committee believes that the provision of a discount to schools cited by the IG for loan agreement violations would be an inappropriate use of the Secretary's discount authority. Schools which take advantage of the program should not be rewarded for their misdeeds.

The IG issued 10 individual audit reports on CHLP and AFLP loans. Of the ten schools audited, nine were found to have under-reported project revenues to DOEd.[9] The fact that 90 percent of the

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[6] General Accounting Office Discussion Paper, "Delinquencies Under Federal Construction Loans to Institutions of Higher Education—An Introduction," March 16, 1982. The internal memorandum of Ottawa University was cited in this discussion paper 19.

[7] Department of Education Office of Inspector General, "Audit of Selected Aspects of College Housing and Academic Facilities Loan Programs—Alaska Pacific University, Anchorage, Alaska," June 10, 1983.

[8] Memorandum of Charles G. Hurley, Regional Inspector General for Investigation, Region IX-X, "Preliminary Inquiry Closing, Alaska Pacific University, Anchorage, Alaska, Inquiry No. 84-590138," Apr. 2, 1984.

[9] The nine schools cited by the IG for under-reported revenues are Alaska Pacific University, Bethel College, Florida Memorial College, Hawaii Loa College, Huron College, Keuka College, Shaw University, University of Steubenville and Viterbo College.

schools audited by the IG were under-reporting their revenues indicates there is enormous potential for colleges in default on their loans to avoid repayment by providing inaccurate accounting information to DOEd. Moreover, the audits expose a serious weakness in the loan management system of the CHLP, and point to a need for more and continuing audits of colleges in default on their loans. In several cases examined by the subcommittee, payment deferments were granted to colleges which had under-reported building revenues.

In some instances, colleges that under-reported project revenues continued to make payments to private creditors while defaulting on their DOEd loans. For example, the DOEd IG audit of Hawaii Loa College found that the school had charged unallowable costs to its CHLP-financed dormitory and was past due on its loan payments, yet still paid private creditors.[10] The main reason the school gave inequitable treatment to DOEd was the Department's lenient collection policies, according to the testimony of Mitchell L. Laine, DOEd Assistant Inspector General for Audit.[11] Mr. Laine also testified that schools which under-report project revenues to DOEd are engaged in "abuse or fraud." [12]

DOEd officials testified at the May 15, 1984, hearing that they would like to penalize delinquent borrowers who under-report project revenues by offsetting loan payments against other Federal education funds, such as student aid. However, the officials testified that the Department lacked authority to offset payments, and asked that Congress provide such enforcement power to the CHLP and AFLP.[13]

B. SOME COLLEGES WHICH ARE PAST DUE ON LOAN PAYMENTS ARE LEASING BUILDINGS CONSTRUCTED WITH DOED LOANS TO OTHER FEDERAL AGENCIES, BUT ARE NOT USING THE LEASE REVENUES FOR PAYMENT OF THE DELINQUENT DEBTS

In cases where colleges are delinquent on their CHLP loans, DOEd "will permit and may require a borrower to convert an ED facility to another use in order to be utilized for purposes other than originally intended. The facility may be rented or leased to third parties providing that all net revenues are applied to the outstanding loan balance." [14]

The subcommittee's investigation discovered that some colleges in default on their Federal loans leased buildings constructed with loan proceeds to other Federal agencies, but did not use all of the lease revenues for debt repayment, as required by DOEd. In effect, these schools received double Federal benefits. They received Fed-

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[10] Department of Education Office of Inspector General, "Hawaii Loa College—Review of the College Housing Program and Academic Facilities Loan Program for the two year period July 1, 1980 to June 30, 1982."

[11] Hearing before a subcommittee of the Committee on Government Operations, House of Representatives, "Department of Education's College Construction Loan Programs," May 15, 1984, hereinafter referred to as Hearing, p. 184.

[12] Ibid., p. 182.

[13] Hearing, testimony of Ronald Kimberling, Ph.D., Deputy Assistant Secretary for Higher Education Programs, Department of Education, p. 245.

[14] Department of Education, Division of Facilities and General Support Programs, Loan Management Branch, "College Housing Loan Program Loan Management Manual," 1983.

eral lease revenues for buildings constructed with Federal loan funds while, at the same time, not making debt repayments.

Alaska Pacific University, for example, received permission from DOEd to lease Gould Hall, a building constructed with CHLP loan funds, to the U.S. Geological Survey. In December 1981, the Survey began using the building under a five-year agreement calling for lease payments of $283,945 a year.[15]

The subcommittee chairman questioned Dr. Ronald Kimberling, Deputy Assistant Secretary for Higher Education Programs, about Alaska Pacific's lease arrangement during the subcommittee's oversight hearing:

> Mr. WEISS. . . . Were all the leasing revenues used for debt repayment?
>
> Dr. KIMBERLING. I do not believe so. Some of the revenues were used in deferment workout agreements for 2 consecutive years in 1982 and 1983, but not all of those revenues have been applied to payment of this loan.
>
> Mr. WEISS. Doesn't the loan agreement require that all revenues from the federally financed projects be used to repay the college housing loans?
>
> Dr. KIMBERLING. Yes, sir.
>
> Mr. WEISS. As a matter of fact, if you had the 5 years of $283,000 a year from the U.S. Geological Survey, you would practically have no deficiency at all; isn't that correct?
>
> Dr. KIMBERLING. Well, I haven't tallied up the numbers, but it could be the case.[16]

Dr. Kimberling also testified that deferments on loan payments were granted to Alaska Pacific by DOEd during the same years that Gould Hall was being leased to the U.S. Geological Survey.[17]

Husson College of Bangor, Maine, has been leasing a building constructed with Federal loan funds to the Labor Department Job Corps for $184,000 a year since 1979. At the time of the subcommittee's hearing, the school was delinquent on $2 million of a total $6 million in CHLP and AFLP loans. The lease revenues were not applied to the past due principal and interest.[18]

Since 1978, the Job Corps has also been leasing facilities constructed with Federal loans from Kittrell College of Kettrell, North Carolina, for approximately $60,000 a year. The school received three CHLP loans totaling $1.4 million, and, at the time of the subcommittee's hearing, was $236,000 in arrears on the loans. On January 31, 1984, DOEd granted Kittrell a one-year moratorium on principal loan payments.[19]

DOEd officials testified that they consider the leasing of project buildings to be an improper act, when leasing revenues are not applied to debt repayment.[20] However, the officials had no plan for

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[15] DOEd IG Audit, "Alaska Pacific University," Apr. 2, 1984.
[16] Hearing, questioning of Dr. Kimberling, p. 246.
[17] Ibid. p. 247.
[18] Ibid. p. 259.
[19] Ibid. p. 259.
[20] Ibid. p. 260.

corrective action in cases where schools in default on their loans continue to lease project facilities to private or public agencies.

C. HOUSING SHORTAGES ARE NOT ADEQUATELY VERIFIED BY DOEd PRIOR TO THE DISBURSEMENT OF LOAN FUNDS

Institutions which apply for CHLP assistance must demonstrate a housing shortage to qualify for loans.[21] However, despite this requirement, the Department's criteria for determining housing shortages have allowed the award of loans to colleges which do not have a true housing shortage at the time of loan disbursement.

For example, the University of Washington received a $3.2 million CHLP loan in 1982. While the application for the loan was being processed, a Seattle real estate developer who owns private student housing protested the loan, claiming that there was not a housing shortage in Seattle, and that award of the loan would jeopardize his business.

The Secretary of Education asked the DOEd IG to investigate the developer's complaint. After conducting an investigation, the IG notified Secretary Bell on July 25, 1982, that, "We have been advised by the Office of General Counsel that the ample availability of housing in Seattle at the present time does not impact on the decision to execute the loan agreement currently pending; therefore, we are not providing information on the housing situation as it now exists."[22] The school applied for the loan in 1980, but did not receive the loan until 1982, when the housing situation in Seattle improved dramatically.

The DOEd Assistant IG for Audit testified that DOEd awards loans based on outdated housing data, and he recommended that loans be awarded only after determining that the housing shortage at the time of application still exists at the time of the loan award.[23]

Another deficiency discovered during the subcommittee's review of the CHLP and AFLP involved the apparent falsifying of housing shortage data in the application of Creighton University of Omaha, Nebraska, for a college housing loan. Creighton received a $3.5 million loan to purchase apartment buildings for use as college housing. An investigation by the DOEd IG determined that, in its application for the loan, Creighton stated that 668 students lived more than a one-hour commute from campus. (Commuting distance is a criterion DOEd uses to determine housing shortages.) The IG investigation found that 476 of the students listed as living more than one hour from campus actually lived in an apartment complex five blocks from the school. The investigation also found that DOEd officials had advised the school to list the students as living more than one hour from campus because the building they lived in was to be sold.[24]

The IG investigation contained the following comments:

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[21] 34 CFR, part 614.24.

[22] Memorandum of James B. Thomas, Jr., Inspector General, "Review of College Housing Loan Application by the University of Washington," June 25, 1982.

[23] Hearing, testimony of Mitchell L. Laine, Assistant Inspector General for Audit, p. 181.

[24] Department of Education Investigation, No. 83-570067.

> Because of the false statements influenced by Federal officials, Creighton University was ranked number 18 of the 19 institutions that were awarded loans [in 1983]. In our opinion, had Creighton University's application been ranked based on the true count of students living beyond a commuting distance of one-hour travel time, rather than the false information submitted, the University would have been ranked too low to receive a loan. The false application resulted in $3.5 million not being available to fund College Housing Program loans to institutions that were truly in need of the funds.[25]

Because Creighton acted on the advice of DOEd officials, and did not intend to submit fraudulent information, the IG closed the investigation. The committee believes, however, that DOEd officials acted improperly in this case. The officials suggested that false information be included in the school's application to compensate for the closing of an apartment building.

D. DOED IS NOT VERIFYING THE CONDITION OR UTILIZATION OF BUILDINGS CONSTRUCTED WITH CHLP AND AFLP FUNDS

Construction, renovations or purchases made with CHLP and AFLP loans is limited to facilities that will be used only for educational purposes. However, DOEd has no system for verifying building use. When the subcommittee chairman asked Dr. Edward M. Elmendorf, Assistant Secretary for Postssecondary Education, how the Department verifies that buldings are used for educational purposes, as prescribed by law, Dr. Elmendorf replied: "We have no way at this time."[26]

Dr. Elmendorf added that DOEd plans to institute a monitoring plan for the CHLP, AFLP and other Federal higher education programs, but did not provide specific details on the nature of the plan.[27]

The committee believes that verifying facilities financed by program loans are used for educational purposes should be an essential function of the CHLP and AFLP. Engineering inspections to determine the safety and quality of project buildings should be of equal importance, yet the subcommittee's investigation also found that buildings financed by Federal loan funds have not received Federal engineering inspections.

According to an audit prepared by the DOEd IG:

> ED loans could be better secured if site inspections and appraisals were performed by qualified individuals prior to project close-out. Site inspections would provide first-hand knowledge of the building—design compliance, materials used, costs incurred, construction problems and other conditions that would affect the value of the facility. Site inspections with an appraisal would better secure the loan in the event of default or foreclosure.

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[25] Ibid.
[26] Hearing, testimony of Edward M. Elmendorf, Ph.D., Assistant Secretary for Postsecondary Education, Department of Education, p. 238.
[27] Ibid.

ED's interim service agreement with HUD did not include a requirement for site inspections and appraisals prior to project close-out.[28] Since assuming management of the CHLP in May 1981, ED has had neither the staff nor the expertise to perform site inspections and appraisals.

In the past, the Department of Health and Human Services' Regional Office of Facilities, Engineering, and Construction (ROFEC) had provided inspection and appraisal services for the AFLP. At the time of our review, ED was negotiating an agreement with ROFEC to perform inspection and appraisal services for the CHLP. Since then, we understand that ED has secured the agreement. However, the agreement includes that inspections will be performed for future construction and rehabilitation only.[29]

During the first 15 months that DOEd managed the CHLP and AFLP, nine buildings financed by the programs were constructed without Federal engineering inspections.[30] Delays in acquiring engineering support for the program, given the amount of funds at stake, and the fact that the buildings are pledged as security for Federal loans, were inexcusable. Moreover, once the engineering support was obtained, according to the IG audit, the nine buildings were still not inspected.

The engineering inspections now conducted by DOEd, through its agreement with ROFEC, only include inspections prior to close-out of the Federal loans. Engineering inspections are not conducted by ROFEC engineers to determine the condition of buildings after loan close-out.

The programs require participating colleges to pay audit and inspection fees, which are used to pay for site visits by DOEd personnel to inspect building conditions and review school financial records. The site visits are the only efficient method available to DOEd to monitor the condition of buildings financed by Federal loans.

HUD collected audit and inspection fees from borrowers to fund site inspections, and DOEd was expected to continue the practice. On May 9, 1980, OMB ordered HUD to transfer all audit and inspection fees collected from borrowers to DOEd in order to fund continuing site inspections. However, at the time of the subcommittee's hearing—almost exactly four years after the OMB directive—the transfer had still not occurred. DOEd officials estimated that HUD may have retained between $1 million and $4 million in fees.[31]

These funds are vital to the program. The additional funds withheld by HUD could be used for site visits to inspect building conditions, review financial records, and collect past due loan payments. Additional visits would also be a message to program participants

[28] During the transition period when the CHLP was transferred from HUD to DOEd, HUD agreed to continue certain management services pertaining to the program. Engineering inspections were not included during this period.

[29] Office of Inspector General, Office of Audit, "Review of the College Housing and Academic Facilities Loan Programs," ACN 10-30010, October 1983.

[30] Hearing, material submitted for the record by DOEd, p. 239.

[31] Hearing, testimony of Thomas Stack, Director, Credit Management Improvement Staff, Department of Education, p. 241.

that DOEd is aggressively monitoring colleges with outstanding loans, and that the types of violations uncovered during the subcommittee's investigation would not be tolerated.

E. COLLEGES IN DEFAULT ON THEIR CHLP AND AFLP LOANS CONTINUE TO RECEIVE OTHER FEDERAL EDUCATION ASSISTANCE

The threat of losing additional aid, and thus student enrollment, would be a powerful enforcement tool for DOEd to use in collecting past due debts. Schools in default on education construction loans are still eligible for other types of Federal education assistance, much of it in the form of student aid.

DOEd officials testified before the subcommittee that delinquent borrowers are ineligible for additional loans from both the CHLP and AFLP. The officials stated that DOEd does not have legal authority to deny other types of Federal education assistance to defaulted institutions, but is pursuing the idea of prohibiting delinquent schools from receiving other types of assistance.[32]

An internal DOEd memorandum noted that "substantial Federal aid has continued to flow to schools in default . . . ED's current policies and procedures in awarding new grants to institutions fail to take into consideration whether or not schools have been in default under other education programs."[33]

A review of DOEd records indicates that schools in default on CHLP and AFLP loans are still receiving millions of dollars in other types of Federal education assistance from the Department.[34]

The committee believes that schools in default on loans for reasons involving financial hardship should remain eligible for other types of Federal assistance. However, schools which have been cited for intentional loan violations should not continue to receive education funds.

F. SOME SCHOOLS IN DEFAULT ON CONSTRUCTION LOANS ARE CURRENT ON PRIVATE DEBTS AND DO NOT GIVE DOED LOANS EQUAL CONSIDERATION

Some schools which are delinquent on their CHLP or AFLP loans remain current on their concurrent private debts while not making payments on DOEd loans. Several IG audits cited schools that gave unequal treatment to DOEd loans. For example, the IG audit of Viterbo College of LaCrosse, Wisconsin, contained the following finding:

> Viterbo College has not been consistent or equitable in its repayment of debt to the Federal government. It made debt service payments through St. Rose Convent (prepaying both principal and interest) and acquired real estate while in arrears on both its College Housing Loan and its Academic Facilities Loan. Past due principal on the $1,158,000 College Housing Loan currently totals $217,000. Past due principal and interest on the original trust inden-

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[32] Hearing, Kimberling testimony, p. 266.
[33] Memorandum from Director, Budget Service, Office of Planning, Budget and Evaluation to Comptroller, "Federal Loans and Grants to Institutions in Default," Aug. 3, 1982.
[34] Department of Education, "CASPER Profile Report for Institutions Receiving Loans from College Housing and Academic Facilities Programs," May 7, 1984.

ture for the $2,500,000 Academic Facilities Loan currently totals $857,000.

Although no specific evidence was available to determine the cause for Viterbo's inequitable treatment of Federal debt service payments, we believe the college pursued this policy because of ED's lenient loan policies, the low loan interest rate charged on outstanding principal amounts, and the absence of late payment penalties. As a result, Viterbo has remained continuously in arrears on its Federal loans to the detriment of the Federal government.* * *

The actions taken by Viterbo to secure deferral of the Federal debt, meet its property acquisition and construction goals, and maintain debt service payments to commercial lenders may be substantially benefitting the college. The benefit, however, is being achieved at a substantial cost to the government. In recent years, interest paid by the Federal government on publicly held debt has ranged from 9 to 15 percent. Viterbo College is obligated to repay the defaulted principal at the original low rates and is not obligated to pay interest on the defaulted interest. We estimated the excess cost to the government of financing the deferred principal, none of which is scheduled for repayment until 1999. At an estimated interest rate of 10 percent per annum, the Federal Government will incur over $2.2 million in interest charges to finance the principal payments deferred by the AFLP Supplemental Agreement.[35]

Tennessee Wesleyan College of Athens, Tennessee, is another example of a program participant giving unequal treatment to DOEd loans. The college received two CHLP loans totaling $1.3 million in 1956 and 1961, respectively. The outstanding principal on these loans is $849,000, with $401,413 in delinquent principal and interest. The school has made no principal payments since 1976, and paid interest of only $3,000 between 1977 and 1980, at the time of the subcommittee's investigation. Yet during the same period, Tennessee Wesleyan remained current on a private dormitory construction loan of $487,000 obtained in 1967 from a local industrial development board.[36]

In response to these findings, Dr. Elmendorf testified during the subcommittee's hearing that "I think the institutions looking at their own best interests are going to pay off the highest interest rate loans. I don't think we can tolerate that, and one of the things that we might propose is offsetting legislation. Such legislation could provide a negative enforcement tool that would restrict the continuous flow of student financial aid dollars to an institution

[35] Department of Education Office of Inspector General, "Report on Audit of Selected Aspects of the College Housing and Academic Facilities Loan Programs at Viterbo College for Fiscal Years 1981 and 1982, Viterbo College, LaCrosse, Wisconsin," Apr. 26, 1984.

[36] Staff investigative findings based on DOEd loan records. The investigation also found that the school's financial statements indicate net revenues from pledged project facilities amount to $96,000 for 1981 through 1983, but the school did not use the funds for repayment of DOEd loans. In February 1984, Tennessee Wesleyan and DOEd ratified a workout agreement allowing the college to repay the past due principal and interest over an 8-year period, with payments to run concurrently with regularly scheduled payments.

that finds itself in the position of choosing to pay private creditors rather than meeting their obligation to pay the Department of Education."[37]

The committee agrees that an enforcement mechanism that would give DOEd loans equal treatment with private loans should be formulated by the Department, in conjunction with the proper legislative authorizing committee.

The subcommittee's investigation found that the unequal treatment given DOEd by program participants is symptomatic of the Department's lenient loan policies. The borrowing institutions have viewed the CHLP and AFLP as paper tigers. This view was confirmed by representatives of delinquent college borrowers during a meeting held on February 22, 1982, by the Conference of Small Private Colleges. The minutes of the meeting offer a behind-the-scenes perspective on the thoughts of college officials in regard to the CHLP and AFLP.[38] Much of the discussion was about loan management practices at HUD, when it managed the program. The meeting was called to discuss methods of combating loan collections in the wake of the Reagan Administration's tough rhetoric about new collection policies.

An unnamed representative of Keuka College of Keuka Park, New York, stated during the meeting that, "We were not required to put up reserves or collateral for our HUD loans. Over the past several years, we have asked for deferments. Our greatest difficulty has been that we keep asking the government for deferments, but have not had a written response since 1979. We assume silence means consent, and therefore, we recognize annual deferments as footnotes in our annual reports."[39]

The minutes contained the following observation: "Perhaps 'silence is golden' can be used to describe the Keuka experience. It was suggested . . . that defaulting institutions should stay low keyed and wait until the federal government makes the first move. However, once the government does move, the colleges should be prepared with workout agreements, but save their 'big guns' (i.e. influential Congressmen) until last."[40]

A representative of Mount Scenario College of Wisconsin described the school's experience with the loan programs this way: "Our college experienced a number of deficits over the past years, and we have not been able to service our debt. We have had annual deferments on our academic facilities loans and some deferments on our HUD loans. With respect to academic facilities, we made an agreement which would make us current on our debt due in 1996. We do not expect to abide by this agreement, but we had to agree to something in order to survive."[41]

The minutes describe Barat College of Illinois as having "requested deferments on principal and interest of our HUD loans for 1979, 1980, 1981 and 1982, and we have had a series of no answers

[37] Hearing, Elmendorf testimony, p. 261.
[38] Conference of Small Private Colleges, "Minutes of February 22, 1982 Meeting With Presidents and Other Administrators of Defaulting Institutions and Representatives of Higher Education Associations," Feb. 22, 1982.
[39] Ibid.
[40] Ibid.
[41] Ibid.

from the government officials. We once got a verbal OK for a 2 year deferment . . . but nothing in writing. However, the longer I don't hear, the better I feel. The footnotes in our annual report state that we have approval for the loan deferments."[42]

A representative of Shaw College of Raleigh, North Carolina, said, "We have been in default for a number of years. I suspect that John Pisano [a HUD official once responsible for the program] did a lot of things he should not have done. But I think he was trying to be cooperative."[43]

The minutes indicate that college administrators were concerned that DOEd, under the new Administration, would be tougher on delinquent borrowers. The minutes state that the administrators were warned that Federal auditors were "spies," and "to be careful if an auditor comes to their college representing another federal program. Although he may be auditing a different college unit, the fact is that the government auditors do talk to each other. Thus, if you are delinquent in your housing loans, you might get a student aid review. Beware!"[44]

The administrators were also advised, according to the minutes, to "hold your big guns until later. As long as negotiations [with DOEd] can be considered reasonable, do not call in your Congressman. However, it is the time to call him in when things become outrageous."[45]

In reference to the minutes, Dr. Kimberling of DOEd testified that, "We are very disturbed by this strategy. We are very disturbed when any group or association talks about such strategies."[46] Kimberling noted that the strategy was being developed in response to the stricter enforcement policies being developed by DOEd.[47]

The subcommittee's investigation found, however, that DOEd's loan management practices, albeit improved in some respects from those of HUD, continued a long Federal record of leniency toward delinquent borrowers. The Department continued the HUD practice of granting deferments to colleges in default.[48]

G. THE CHLP AND AFLP LOAN MANAGEMENT AND COLLECTION OF DELINQUENT DEBTS ARE DEFICIENT DUE TO LENIENT POLICIES AND INSUFFICIENT RESOURCES

The Loan Management Branch, which is responsible for all loans in the CHLP and AFLP, has several options it can use to remedy defaults. The strongest remedies available are foreclosure or placing the building financed by the loan in receivership. In addition, the Loan Management Branch may also defer payments, grant one-year moratoriums or recast the terms of the loan, in order to help

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[42] Ibid.
[43] Ibid.
[44] Ibid.
[45] Ibid.
[46] Hearing, Kimberling testimony, p. 208.
[47] Ibid.
[48] DOEd differentiates deferments from workout agreements. A worker agreement calls for the delinquent borrower to agree to pay past due principal and interest for a set period of time while current principal and interest are paid concurrently. For the purposes of this report, the committee considers a workout agreement to be synonymous with a deferment because it allows past due funds to be deferred.

the borrower reach a stronger financial condition.[49] In most cases examined by the subcommittee, DOEd, and HUD before it, chose to exercise deferment options or recast the loan. The only cases where foreclosure was used involved schools that had filed for bankruptcy or had otherwise ceased functioning as an educational institution, leaving DOEd no other options. Receivership had not been used as a default remedy.[50]

At the time of the subcommittee's hearing, there was a total of $162.7 million of loans in default. Of the loans in default, 65 percent were in workout agreements, 27 percent were pending remedial action, 6 percent were in foreclosure and the rest were deferred.

The resources available to the Loan Management Branch are minimal and, as a result, loan officers must concentrate most of their time on collection of past due debts, to the possible detriment of the majority of the loan portfolio, which is in current status. In its audit of the CHLP and AFLP, the DOEd IG noted:

> The Loan Management Branch has the responsibility to administer the repayment of 3,939 outstanding loans, totaling $3.3 billion, under the CHLP and AFLP. Of these loans, 215 loans ($33.5 million) was in default at the time of our review. Each of the Branch's seven loan specialists was responsible for an average of about 563 loans—about 30 of which were in default.
>
> Because of the emphasis on debt collection, the loan specialists concentrated their efforts on obtaining audited Loan Management Reports, audited financial statements, letters of explanation for the default, and proposed workout agreements from all defaulted institutions. Upon receipt of the requested documents, the loan specialists review and evaluate the information and perform various analyses of the financial data. Also, the loan specialists recommend approval or denial of any proposed workout agreement. Sometimes, this requires a site visit to the institution.
>
> However, the heavy caseload, in conjunction with the emphasis on debt collection, left little staff time to classify and assess the viability of borrowers whose loans were not in default. Because of the emphasis on defaulted loans, the loan specialists were not identifying institutions with a high potential for default. Loan specialists became aware of a potential default only after an institution failed to make a debt service payment.
>
> In our opinion, the incidence of default could be reduced if institutions with adverse financial problems are identified.[51]

The audit also noted that the DOEd Task Force for Human Resources Analysis and Review, issued on December 17, 1982, had recommended that additional staff positions be made available to the Loan Management Branch to improve the branch's performance.[52]

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[49] Loan Management Manual, 1983.
[50] Hearing, testimony of Kimberling and Elmendorf, pp. 206 and 207.
[51] "Review of the College Housing and Academic Facilities Loan Programs," October 1983.
[52] Ibid.

At the time of the subcommittee's hearing, new staff positions had not been allocated.

The borrowing institutions are aware that CHLP and AFLP officials are likely to choose the most lenient approach in dealing with a delinquent borrower and that the Loan Management Branch lacks resources to monitor all loans in the portfolio. These deficiencies have sent a signal to program participants that loan security controls are lax. The colleges expect even more leniency due to the promulgation of a regulation that allows DOEd to discount all outstanding CHLP loans by as much as 55 percent.[53]

Section 308 of P.L. 98-139 (the DOEd FY 1984 Appropriation Act), amended the Housing Act of 1950 by giving the Secretary of Education authority to accept discounted prepayments of outstanding CHLP loans. On April 20, 1984, DOEd published a proposed regulation that will allow discounts of as much as 55 percent, under a complicated formula (the regulation was published in final form on July 17, 1984). The theory behind the formula is that the amount discounted will be equal to the cost to the Treasury of subsidizing each loan. For example, Virginia Commonwealth University recently received a $4 million CHLP loan. Under the discount formula, if the school agrees to prepay its loan in total, the amount owed DOEd will be only $1.8 milllion, a windfall of $2.2 million for the school. In this case, DOEd estimates that the cost to the Treasury of subsidizing the loan will total $2.2 million.

All colleges, whether current or in default, will be eligible for the discount, and DOEd has recommended that all schools apply for the discount. Under the law, the discount authority expires on October 1, 1984, but DOEd has asked Congress to extend the authority for an additional year.[54]

The program has a liability of nearly $3 billion to the Treasury based on borrowings for program capital and an additional $471 million liability on GNMA bonds. With approximatley $3 billion in loans outstanding, and the potential for more than half of that to be discounted, the committee is concerned that DOEd will not be able to repay its debt on the Treasury borrowings and GNMA bonds. The cost to the Treasury, theoretically, could be much greater than the cost of subsidizing the difference between the 3 percent interest charged on the CHLP and AFLP loans and the current Treasury rate.

The discount appears to be based on an assumption that the funds collected through use of the discount authority will be reinvested, and have a return equal to the daily Treasury borrowing rate. However, if the Congress continues the program, the CHLP and AFLP liability to the Treasury could not be repaid without new appropriations.

The idea for the discount regulation emanated from Alaska Pacific University, a program participant that is in default on its CHLP loan and in violation of key provisions of its loan agreement.[55] On November 2, 1983, after the discount provision became

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[53] 34 CFR part 614.

[54] The Senate version of the DOEd appropriations bill contains a provision to extend the discount authority, but the House version does not include the extension.

[55] Dr. Kimberling testified that a representative of Alaska Pacific University brought the idea for the discount authority to the attention of DOEd officials (Hearing, p. 253), and that the De-

Continued

law, Dr. Kimberling instructed his staff to "begin negotiations with . . . Alaska Pacific."[56] The instructions prompted the following exchange between the subcommittee chairman and Dr. Kimberling:

> Mr. WEISS. Why, Dr. Kimberling, were you negotiating or directing negotiations with Alaska Pacific University in November of 1983, 6 months before the regulation on discounting was even published for public comment?
>
> Dr. KIMBERLING. Mr. Chairman, Alaska Pacific had expressed an interest in the discount provision. My understanding at the time of that memorandum was that the basic statute would give us authority to apply the discount provision.
>
> After I issued that memorandum, anxious to get on with the show now that the law had passed, I was informed that we did in fact have to go through the regulatory procedure. I was under the mistaken impression that the law itself, that the basic statute, was clear enough that we did not have to go through the process of developing regulations.
>
> As soon as we learned that the regulations needed to be developed, we did not negotiate. We have not reached any kind of a settlement. We have not finalized anything with Alaska Pacific University. My training is not in law, and I was less informed of the procedures than I perhaps should have been. I was not aware that regulations needed to be issued in this case.[57]

The IG audit findings regarding Alaska Pacific University's violation of its loan agreement were issued on June 10, 1983, more than four months before Dr. Kimberling had instructed his staff to negotiate with Alaska Pacific University. Dr. Kimberling testified that he did not recall seeing the audit, although it was forwarded to his office for review.[58]

The committee believes the granting of the discount to Alaska Pacific would be unfair to the thousands of schools which are current on their loan payments, and have not violated loan agreement restrictions. Moreover, the committee finds the involvement in the formulation of the discount law and regulation of a school cited by the IG for direct program violations while it was in default on program loans to be a questionable and indiscreet use of management authority by DOEd officials.

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partment worked with Senator Stevens of Alaska in formulating the legislation creating the discount authority. As noted previously in this report, the DOEd IG found that Alaska Pacific under-reported project revenues to DOEd, leased a building financed with CHLP funds to the Labor Department while remaining delinquent on its debt and appears to have sufficient resources to repay its CHLP loan.

[56] Memorandum of Richard L. Fairley, Director, Institutional Support Programs, "Implementing Discount Authority on Housing Loans." The memorandum was sent to Dr. Kimberling, and states: "Your [Dr. Kimberling's] control memo of November 2, 1983, requested the following: 1. Work out with program and Margaret Conway the procedures for approving discount requests from institutions; 2. Begin negotiations with Attorney Silver of Alaska Pacific; and, 3. Prepare draft letter, for my signature, that would go to the presidents of all schools with outstanding housing loans informing them of this provision and encouraging them to take advantage of it before the authority runs out." Dr. Kimberling confirmed that these were his instructions, p. 253, hearing record.

[57] Hearing, Kimberling testimony, p. 253.

[58] Ibid., p. 256.

At the time of the subcommittee's investigation, DOEd appeared prepared to grant the discount to Alaska Pacific. Computations supplied by the Loan Management Branch to the subcommittee showed that the school would be permitted to pay off a $1.39 million loan balance with a one-time payment of $650,104.[59]

Although DOEd moved quickly in finalizing the discount regulation, it has not managed to publish loan management regulations of any kind. Loan management regulations would strengthen DOEd's position in dealing with delinquent borrowers, and establish criteria for the Department to use in reducing defaults.

The final DOEd CHLP regulations were published on May 20, 1982.[60] The new rules abolished the old HUD regulations, which DOEd had used as criteria for program administration. However, when the new regulations were published, DOEd did not include new loan management regulations which had already been drafted for final publication. The draft regulations that were not published included strict requirements to be met before financial relief can be granted to a delinquent borrower by DOEd. Included in the draft regulations is a stipulation that a deferment can only be granted when, "The pledged revenues of the ED-assisted facilities, any pledged revenues from other facilities, and any pledged funds or securities are being properly accounted for and applied in accordance with the Loan Requirements."[61]

The committee believes the regulations should have been published two years ago, and certainly should be published for comment now. The committee also believes that the eligibility criteria used for granting financial relief, contained in the draft loan management regulation, should also apply to schools applying for loan discounts.

DOEd officials assured the subcommittee that the loan management regulations would be published.[62]

H. DOEd DID NOT ENSURE THAT ALL BORROWERS WERE ACCREDITED HIGHER EDUCATION INSTITUTIONS PRIOR TO AWARDING CONSTRUCTION LOANS

Only accredited colleges or universities, or public educational institutions operated by accredited colleges or universities, are eligible for DOEd construction loans.[63] Accreditation is not granted by DOEd, but by regional higher education associations. The subcommittee's investigation found that the DOEd process for checking the accreditation of borrowing institutions is inadequate, and in one case, allowed a school which had lost its accreditation to receive program loan funds.

The case involves Mississippi Industrial College, which received a CHLP loan in 1975 and an AFLP loan in 1981. The two loans total $856,000. The school was delinquent nearly $100,000 in principal and interest payments at the time of the subcommittee's investigation. On December 12, 1980, the Southern Association of Colleges

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[59] Loan Management Branch, "Department of Education Loan Discounting Program—Alaska Pacific University," Apr. 24, 1984.
[60] 34 CFR part 614.
[61] Department of Education, "Draft Regulations," 34 CFR part 614, subpart F.
[62] Hearing, Kimberling testimony, p. 264.
[63] 34 CFR part 614, subpart A 614.2.

and Schools withdrew the college's official accreditation, rendering the school ineligible for Federal education assistance. DOEd was not notified of the withdrawal of accreditation until October 1981. In November 1981, DOEd disbursed final loan proceeds of $402,000 to the college.[64]

DOEd officials blamed the snafu on the failure of the accreditation association to promptly notify the Department of the withdrawal of accreditation.[65] However, the committee believes that when DOEd staff did learn of the withdrawal approximately one month before the disbursal of loan funds, that information should have been immediately transmitted to all DOEd offices responsible for educational assistance funding. According to testimony at the subcommittee's hearing, DOEd has purchased a computer system that will allow such information to be transmitted automatically and instantly to all program offices.[66]

The subcommittee's investigation found additional problems regarding the loan to Mississippi Industrial College. The buildings financed with Federal funds are incomplete, unusable, and deteriorating. DOEd cannot account for all loan proceeds disbursed to the school, and at the time of the subcommittee's investigation, had not attempted to learn the disposition of those funds.[67] The college is now under investigation by several Federal agencies.

I. CHLP AND AFLP LOAN DOCUMENT CONTROLS NEED IMPROVEMENT

Loan files and billing documents were handled haphazardly by DOEd, particularly during the first several years after the loan programs were transferred to the Department. For example, the IG found that:

> The Department of Education had not always provided the FRB with the necessary documents to initiate the billing and collection of the CHLP loans. Of the 111 CHLP loans closed between May 1981 and February 1983, 27 may not be in pay status with the FRB. Original loan documents for 21 loans were in files located at either the College Facilities Branch or Financial Management Services. Original loan documents for the remaining 6 loans could not be located at either ED or the FRB. Consequently, the FRB may not have initiated collection actions on these loans—21 of which amount to $19.6 million.* * *
>
> For 11 of 21 loans, original loan documents were in the files at Financial Management Services. These loans were fully disbursed and the documents should have been forwarded to the FRB. Six of these loans totaled $10,017,500 with initial principal and interest payments totaling $231,967 past due. For the remaining five loans, information was not provided to us on the loan amounts or principal and interest payments. ED became aware that some

[64] Information contained in Memorandum from Chief, Program Operation, to Charles I. Griffith, Chief, College Facilities Branch, "Mississippi Industrial College, Briefing of Accreditation Problem, Supervision of Construction and Results of Site Visit," Oct. 14, 1982.
[65] Hearing, Elmendorf testimony, p. 243.
[66] Ibid.
[67] Memorandum to Charles Griffith.

> loans were closed but not in payment status when the institutions requested instructions for making debt service payments.* * *
>
> Original loan documents for 6 of the 27 closed CHLP loans could not be located at the College Facilities Branch, Financial Management Services, or the FRB. Five of these loans totaled $4,919,000. Financial information was not made available to use for the loan.[68]

This slipshod approach to organizing billing documents was also found in the document filing system used by DOEd when the programs were first transferred to the Department. The CHLP files were transferred from HUD regional offices and were initially stored in cardboard boxes in hallways outside the program offices. Due to the lack of storage space during that time, program officials ordered the destruction of approximately 80 percent of each file. Loan files in current payment status were purged of all documents, except trust indentures and loan agreements.[69]

DOEd officials contend that the files which were destroyed did not contain vital information. However, the committee believes that correspondence between HUD or DOEd and borrowers that could date back for decades would be beneficial to the Government's case in the event of default. The purged documents also included loan management reports that can be used to verify the disposition of pledged project revenues. Without those records, such documentation would be difficult to accurately reconstruct.

The subcommittee's investigation found some improvements in collection and document controls since the IG audit was conducted in 1983. Files are now stored in cabinets and the FRB appears to have all necessary billing records. However, there is still one deficiency in the record coordination process involving the FRB. The FRB only notifies DOEd of payments which are past due. DOEd is not notified on a regular basis of collections and, as a result, it is difficult for program officials to know precisely how much is collected in any given month.

J. LOAN SECURITY CONTROLS NEED IMPROVEMENT

In its role as the provider of loans to colleges, DOEd is required to protect the Federal Government's interests through the use of adequate loan security controls. These controls should guarantee that loan documents contain strict enforcement provisions. The controls must also provide adequate assurances that the loans are secured to protect the taxpayers' investment in the event of borrower default. The trust indentures and loan agreements used by DOEd, and HUD before it, contain basic legal protection for the Government. The security criteria for collateralizing loans also contain adequate protection. However, DOEd's interpretation and implementation of these protective measures is lacking in key areas, and needs to be improved.

When CHLP and AFLP documents are formally ratified at loan closings, DOEd has no legal representative in attendance. A bond

[68] "Review of the College Housing and Academic Facilities Loan Programs," October 1983.
[69] Hearing, information supplied by Mr. Weiss, p. 231.

counsel representing the borrower and trustee also represents the Government's interests at the closing. The bond counsel is paid by the borrower. The committee believes a strong potential for conflict of interest exists when the only legal representative responsible for the interests of DOEd at the loan closing is paid by the borrower.

The DOEd IG is also concerned about the potential for conflict of interest. The IG noted in an audit that:

> Ed had not been represented by legal counsel at loan closings to protect the Government's interests. Only the institution's representatives and lawyers or bond counsel were present. The notes, bonds, trust indentures and other legal documents were prepared by the institution's lawyers or bond counsel. The legal documents were then sent to the College Facilities Branch for review. The Branch was responsible for ensuring that the Government's interests were properly secured. The security for the loans is specified in the loan agreements and executed at loan closing. The staff of the College Facilities Branch at the time of our review did not have legal expertise. The potential exists for the legal documents to contain clauses, unknown to ED, which could cancel ED's rights in the event of foreclosure.[70]

DOEd also is responsible for ensuring that it has a strong mortgage position on buildings used as security for the construction loans and that the buildings are adequately maintained so the worth of the facilities does not depreciate enough to prevent the Government from recouping a fair percentage of loss in the event of foreclosure.

The IG raised questions about DOEd's first mortgage position in some loan cases. The IG noted that:

> There is a difference of opinion on whether ED has secured a first mortgage position when the borrower constructed CHLP facilities on property donated by the Federal Real Property Administration (FRPA). This questionable situation stems from inaction by the College Facilities Branch and HUD to ensure that the borrower obtained abrogation of FRPA's reverter clause which prohibits the institution from mortgaging property donated by FRPA. In the event of default and foreclosure, ED may not be able to recoup its CHLP loan funds because the proceeds of any sale may revert to the Department of Treasury rather than ED. Examples of these conditions were noted for two institutions where $5 million may not have been secured.[71]

The facilities financed by DOEd can be security for the loans for as long as 40 years. DOEd should ensure that these buildings are in good condition during the life of each loan, given the potential that the government could own the buildings in the event of loan default and subsequent foreclosure. Used college dormitories and

[70] "Review of the College Housing and Academic Facilities Loan Programs," October 1983.
[71] Ibid.

other facilities are difficult to sell, but sale probabilities are reduced even further if the building has deteriorated. DOEd is not regularly checking the condition of buildings used as security for CHLP and AFLP loans. The Department does not inspect the buildings enough to even determine if they are being used for educational purposes, as required by the loan agreements. This is particularly true in loans involving borrowers who are in current pay status. Having first mortgage position on a building financed by Federal loans is only a first step. DOEd should also ensure that the worth of the security it holds does not decline to the point where it becomes useless as collateral.

IV. Recommendations

A. Borrowing institutions that have purposely under-reported project revenues pledged for debt repayment to DOEd and borrowers that are delinquent on their CHLP obligations, despite having the financial resources to repay their debts, should not receive discounts on prepayment of loans under 34 CFR Part 614.

Under Section 308 of Public Law 98–139, the Secretary of Education is authorized to accept discounted prepayments of a borrower's entire loan balance. DOEd has interpreted the law to provide eligibility for the discount for institutions in current payment status as well as institutions delinquent on their loan payments. The subcommittee's investigation and audits conducted by the DOEd IG found that some borrowers, who are in default on their loans, intentionally under reported revenues pledged under loan agreements for repayment of CHLP loans. The investigation also found that some borrowers remained delinquent on loan payments, despite having the financial resources to maintain their loan payments. The committee does not believe these borrowers, who represent a small minority of program participants, should be rewarded for their misdeeds with a discount. Providing discounts to borrowers who violate the strictures of their loan agreements would be unfair to the majority of borrowers who are in compliance with program regulations, and would send a message to program participants that violations of law and regulations will not only not be punished, but will be rewarded.

B. All past due loan payments, including funds owed under workout agreements, should be paid prior to the acceptance of discounted prepayments of CHLP loans, and should not be considered part of the loan balance when figuring the discount allowed under 34 CFR Part 614.

Under the discount regulation, DOEd is authorized to accept discounted prepayments of loan balances. The committee does not believe Congress intended for the discount to be applied to payments which are past due, including past due payments that DOEd construes as current as the result of the enactment of a workout agreement.

C. Financial penalties should be assessed against borrowing institutions participating in the CHLP or AFLP that violate their loan agreements.

The only major deterrent available to DOEd against violations of loan agreements is foreclosure. The committee believes interest

penalties or offsetting certain sums against other Federal education assistance available to a borrower should be options available to DOEd in handling delinquent borrowers. However, the committee does not believe colleges in truly dire financial straits should be penalized. In those cases, the proper alternatives should be deferments, moratoriums or workout agreements, options already available to DOEd. Colleges that can afford to maintain their loan payments, but attempt to take advantage of the Government by not meeting their obligations, should be penalized. The committee recommends that DOEd prepare a plan to invoke financial penalties against delinquent borrowers, to be used in appropriate cases. If legislative authority is required to assess such penalties, the committee urges DOEd to submit a draft measure for congressional consideration.

D. DOEd should reform its regulations to establish criteria that call for a housing shortage to occur during the most recent school year prior to the actual disbursal of loan funds.

The committee found that housing shortages do not always exist at a borrowing institution at the time of actual disbursal of loan funds. Current DOEd policy requires loan funds to be disbursed within 18 months of the time a loan application is approved and a loan reservation is made. The committee believes this is too long a period. The housing situation at the applicant's campus can change dramatically in 18 months. The committee recommends that the housing situation during the most recent school year prior to the award of funds be used as the time criterion for determining a housing shortage.

E. The DOEd IG should conduct audits of all schools delinquent for more than six months on their original loan payment schedules.

In nine of the ten audits conducted of defaulted borrowers by the DOEd IG, project revenues had been under-reported to DOEd. Given this high percentage of under-reported revenues, the committee recommends that the IG conduct audits of all borrowers delinquent for more than six months on their original loan schedules to determine the degree of loan agreement violations and the accurate financial ability of the borrower to repay its debt.

F. DOEd should develop a plan to monitor the utilization of all buildings financed by CHLP and AFLP loans that have not been fully repaid to ensure that the facilities are used for educational purposes.

As DOEd officials admitted during the subcommittee's May 15, 1984, hearing, the Department has not verified that all buildings financed by CHLP and AFLP loans are used for educational purposes, as required by loan agreements. The committee believes that verifying that the facilities financed by Federal loans are used for educational purposes should be an essential function of the DOEd programs, and recommends that a monitoring plan be developed and implemented by the Department.

G. DOEd should develop a plan to inspect the condition of all buildings financed by CHLP and AFLP loans that have not been fully repaid to ensure that the buildings are maintained as adequate facilities for students and as sufficient security for DOEd loans.

The committee found that DOEd does no long-term inspections of buildings financed by CHLP and AFLP loans. The committee believes that DOEd is responsible for ensuring that the buildings are maintained as adequate facilities for student use. Moreover, buildings financed by these loans are in themselves security for the loans. DOEd should ensure that the value of the facilities does not depreciate to the point where they are of little protection to the Government in the event of default and subsequent disclosure. The committee recommends that a plan to inspect the condition of buildings be developed and implemented by the Department.

H. DOEd should develop a system that will inform all financial assistance offices of the Department of the latest accreditation position of schools receiving Federal education aid.

At the time of the subcommittee's investigation, accreditation associations were not informing DOEd of withdrawals of accreditation in a timely manner. DOEd also did not disburse accreditation information to its appropriate offices within reasonable time frames. As a result, at least one institution received loan funds after losing its accreditation. The committee recommends that an improved system of disseminating accreditation information be developed and implemented.

I. The Division of Facilities and General Support Programs' Loan Management Branch should have more personnel in order to efficiently manage the CHLP and AFLP programs.

The committee found that, due to a lack of personnel resources, Loan Management Branch personnel spent most of their time on loans in default status, which represent a small minority of the CHLP and AFLP loan portfolios. The committee believes that inattention to loans in current payment status could lead to a worsening default situation, given the large number of loans not monitored. Lack of personnel resources also results in less site visits to borrowing institutions, which the committee believes are an essential part of the monitoring process. The committee recommends that DOEd conduct a study of the Loan Management Branch to determine personnel needs and report the results of the study to the committee.

J. All audit and inspection fees held by HUD should immediately be transferred to DOEd.

The committee found that between $1 million and $4 million in audit and inspection fees collected by HUD had not been transferred to DOEd, despite a 1980 OMB directive ordering the transfer. These funds should be used to finance site inspections of borrowing institutions. DOEd's inability to obtain the transfer of funds from HUD has contributed to loan management deficiencies by limiting the number of audits and inspections. The committee believes site visits are necessary to assure the soundness of the loan and protect the Government's interest in facilities financed with loan proceeds.

ADDITIONAL VIEWS OF HON. ROBERT S. WALKER, HON. FRANK HORTON, HON. JOHN N. ERLENBORN, HON. THOMAS N. KINDNESS, HON. LYLE WILLIAMS, HON. ALFRED A. (AL) McCANDLESS, AND HON. DAN SCHAEFER

We support the Committee's report, but believe that the study and recommendations should be placed in necessary perspective.

The investigation which prompted the Subcommittee hearings and this report focused on audits of ten institutions of higher education conducted by the Department of Education Inspector General (DOEd IG). The institutions identified for audit were selected jointly by the DOEd IG and the DOEd Office of Postsecondary Education (which has jurisdiction over the programs) precisely because they had loans in default status. Obviously, as a result, problems were found. To the extent that abuses exist, they should be corrected. But it is important to keep in mind that program officials participated in the identification of the audited institutions partially as a means by which to find administrative remedies for the defaults, and to bring pressure to bear on those institutions to comply with their loan repayment agreements.

We must also recognize that substantial management improvements have been implemented since the programs were transferred to DOEd in 1980. The number of institutions in default has been reduced from 81 to 67, and work-out agreements have been made with 49 of these 67 institutions. As a result, DOEd has not only reduced the number of defaulted borrowers, but has exceeded target collection goals on defaulted loans, collecting $5.7 million in 1982, $6.7 million in 1983, and projecting a collection of approximately $8 million in 1984. The growth rate in delinquencies has also been slowed considerably—in the College Housing Loan Program, delinquencies increased at a rate of over 200 percent between 1977 and 1980, and at a rate of only 15 percent since 1980; and in the Academic Facilities Loan Program, delinquencies increased at a rate of 340 percent between 1975 and 1980, and at a rate of only 29 percent since 1980. The problem of delinquencies has not been eliminated, but substantial progress is being made.

Finally, and most importantly, we would emphasize that the vast majority of program participants (1,290 of a total of 1,308 institutions that have outstanding loans) are meeting their repayment obligations and fulfilling their commitments to the federal government. Only 18 institutions (1.4 percent) are in actual default for approximately $36 million, or about 1 percent of the total amount outstanding. The report's focus is on that small percentage of institutions that for whatever reason have not met their obligations.

We trust that implementation of the report's recommendations will help DOEd solve remaining problems and make constructive improvements in the future management of the programs. But, we must add that the Department's performance has been improving

greatly, and that most program participants have met their commitments.

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